

INCOME TAX (TRADING AND OTHER INCOME) ACT 2005

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part 4: Savings and investment income

Chapter 8: Profits from deeply discounted securities

Overview

1730. This Chapter rewrites the provisions in Schedule 13 to FA 1996 that deal with “relevant discounted securities”. FA 2003 introduced various changes to Schedule 13, principally repealing reliefs for losses and allowances for expenditure, but with transitional rules for securities held since before 27 March 2003. Since these losses and allowances continue to apply for securities held since that date it was considered more helpful to set out the law relating to them in this Chapter rather than relegate them to Schedule 2 to this Act.

Section 427: Charge to tax on profits from deeply discounted securities

1731. This section charges to tax profits on deeply discounted securities which arise when the security is disposed of (for whatever reason) or, in certain circumstances, is treated as being disposed of. It also ensures that gains which would not otherwise be income are treated as such. The section is based on paragraph 1 of Schedule 13 to FA 1996.

1732. Although Schedule 13 to FA 1996 refers to a “relevant discounted security”, this Act uses the term “deeply discounted security”. This seems a more appropriate term to reflect both the nature of the security and the nature of the tax charge while distinguishing this regime from the “deep gain securities” regime of Schedule 11 to FA 1989.

Section 428: Income charged

1733. This section sets out the amount charged to tax on profits that arise on a disposal of securities that are within or outside the United Kingdom. It is based on sections 64, 65 and 68 of ICTA and on paragraph 1 of Schedule 13 to FA 1996.

1734. Paragraph 1(1) of Schedule 13 to FA 1996 provides that profits arising from a security out of the United Kingdom are chargeable under Schedule D Case IV. This allows the assessment rules for Case IV income in section 65 of ICTA to apply.

1735. *Subsection (3)(a)* treats such profits as arising from a source outside the United Kingdom. This links to the definition of “relevant foreign income” in section 830, thus attracting the special rules for such income in Part 8 of this Act.

1736. *Subsection (3)(b)* then makes the rule in *subsection (1)* subject to the rules in Part 8 of this Act for such profits.

Section 429: Person liable

1737. This section states who is liable for any tax charged. It is based on paragraph 1 of Schedule 13 to FA 1996.

Section 430: Meaning of “deeply discounted security”

1738. This section provides a general definition of “deeply discounted security” for the purposes of Chapter 8. It is based on paragraph 3 of Schedule 13 to FA 1996.

1739. The main test to identify relevant discounted securities is spread over paragraph 3(1), (3) and (4) of Schedule 13 to FA 1996. The test compares the amount payable on redemption with the issue price of the security to see whether, under its terms of issue, it is capable of yielding a “deep discount” on redemption.

1740. A security is capable of yielding a “deep discount” if the amount payable on redemption could exceed the issue price by more than a specified percentage of the amount payable on redemption. In the rare case where the security has an expected life of 30 years or more, the percentage specified is 15%. In all other cases the percentage specified is equal to half the number of years between the date of issue and the date of redemption.

1741. This means that a deep discount occurs where the amount payable on redemption could exceed the issue price and the potential difference amounts to more than 0.5% of the amount payable on redemption for each year of the security’s life. For example, a five year bond issued for £90 and redeemable for £100 is a deeply discounted security because the discount is more than the specified 2.5% (that is, 0.5% for each year of the bond’s life). This is expressed in *subsection (1)* by means of a formula.

Section 431: Excluded occasions of redemption

1742. This section exempts from the charge under this Chapter certain securities which were not issued to gain a tax advantage and where redemption is not within the power of the holder. It is based on paragraph 3 of Schedule 13 to FA 1996.

1743. Under section 430(1) the test for a deep discount can be applied on maturity or any possible occasion of redemption. Those occasions of redemption are ignored if the conditions in subsection (2) or (3) of this section are met.

1744. In *subsection (2)* the conditions in paragraphs 3(1A) and 3(1C) of Schedule 13 to FA 1996 have been amalgamated and renamed “the third-party option conditions”. These apply where the achieving of a tax advantage (defined in section 460(2)) is not a main benefit and the security is issued to a person who is not connected with the issuer (see *subsection (7)* and section 878(5) of this Act) and is not redeemable by the holder.

1745. *Subsection (3)* provides the second conditions which have been renamed “the commercial protection conditions”. These exempt from charge securities which can only be redeemed as the result of an event which in practice is likely to be outside the power of the holder and which could not have been anticipated when the securities were issued.

1746. Under *subsection (4)* neither of these two sets of conditions is considered as met simply because an occasion of redemption happens to take place coincidentally at the same time that one of these sets is met.

1747. For the “third-party option conditions” to apply the security must be issued to a person who is not connected with the issuer. *Subsection (5)* provides that where those conditions are met but the security is then acquired by a connected person (or the holder becomes such a person) the conditions will cease to apply.

1748. *Subsection (6)* deals with the reverse of the condition provided for in subsection (5). Where a person who is not connected with the issuer acquires a security which fails to satisfy the “third-party option conditions” only because it was issued to a person

connected with the issuer, then it ceases to be a deeply discounted security from that date. This subsection also applies where a security which is a deeply discounted security as a result of subsection (5) is acquired.

Section 432: Securities which are not deeply discounted securities

1749. This section excludes certain specified securities from the scope of the general definition of deeply discounted security in section 430. It is based on paragraph 3 of Schedule 13 to FA 1996.

Section 433: Meaning of “excluded indexed security”

1750. This section explains what is meant by an “excluded indexed security” referred to in the previous section. It is based on paragraph 13 of Schedule 13 to FA 1996.

1751. *Subsection (1)* explains that a security is an “excluded indexed security” if the amount payable on redemption depends on any future change in the value of certain assets or on the change in an index of the value of certain assets.

1752. Some securities provide for the investor to get back a percentage of his or her original investment if the value of the assets (or the index) fails to rise to a certain level. This will not prevent the security being a deeply discounted security provided the specified percentage is not more than 10% of the issue price (*subsection (2)*). This means that if £100 is invested the investor must get no more than £10 back, losing the other £90. Unless the investor can lose 90% of the original investment it is not an excluded indexed security but a deeply discounted security.

1753. *Subsection (3)* ensures that interest on redemption is ignored in the calculation under this section. It is clear that this is the intention of the legislation from the fact that paragraph 3(2)(c) of Schedule 13 to FA 1996 takes excluded indexed securities outside the definition of deeply discounted securities and that paragraph 3(6) of that Schedule (rewritten in section 430(4)) excludes interest from the general calculation of deep discounts.

1754. *Subsection (4)* defines “redemption period” for the purpose of this test. This definition differs from the one for the deeply discounted security test in section 430 to allow flexibility for the chargeable assets referred to in subsection (1) to be valued on dates other than, but close to, the issue and redemption dates. Likewise, an index of the value of chargeable assets may not be computed for the actual issue and redemption dates and some approximation is required.

1755. *Subsection (5)* defines “chargeable asset” for the purpose of this test. The underlying premise is that where the disposal of the asset whose value is linked to the security would be within the scope of capital gains tax, then disposals of securities fully linked to the value of such assets should also be subject to capital gains tax and excluded from the income tax regime.

1756. “Chargeable asset” is defined, in paragraph 13(6) of Schedule 13 to FA 1996, as an asset which on disposal can give rise to a chargeable gain for the purposes of TCGA. In order to make this test work it is necessary to make some assumptions about the asset (found in paragraph 13(7) of that Schedule) and these are set out in *subsection (6)*. Section 100 of TCGA applies mainly for corporation tax purposes and unauthorised unit trusts are the only persons liable to income tax benefiting from subsection (6)(b).

Section 434: Securities issued in separate tranches: preliminary

1757. This section introduces two special rules for determining whether securities issued in tranches under a single prospectus are deeply discounted securities. The first rule is called “the basic rule” and the second rule “the nominal value rule”. Broadly, where securities are issued in tranches under a single prospectus, either all of them are treated

as deeply discounted securities or none of them is. The section is based on paragraphs 3 and 10 of Schedule 13 to FA 1996.

1758. *Subsection (2)* explains that following an initial issue of deeply discounted securities under a prospectus the nominal value rule will not apply to any of the securities issued at any time under that prospectus but the basic rule will apply.
1759. *Subsection (3)* explains the position where, in contrast to the position in subsection (2), the original issue does not include any deeply discounted securities. In that case both rules may apply to later issues.

Section 435: Securities issued in separate tranches: basic rule

1760. This section sets out the first rule, known as the basic rule. It is based on paragraph 3 of Schedule 13 to FA 1996.
1761. *Subsection (1)* provides that if any of the securities issued under a prospectus at any time are not deeply discounted securities under section 430, then any securities issued subsequently will not be deeply discounted securities, even if they would be deeply discounted securities under that section. But this will not be the case if a security is a deeply discounted security because it is issued to a person connected with the issuer or acquired by a person who becomes so connected (see *subsection (2)*).
1762. The words “(disregarding that paragraph)” from paragraph 3(2)(f) of Schedule 13 to FA 1996 are not rewritten. They may be read in such a way as to conflict with the words “subject to paragraph 10” at the beginning of paragraph 3(2)(f) of that Schedule, which are clearly intended to prevail.

Section 436: Deeply discounted securities issued in separate tranches: nominal value rule

1763. This section sets out the second rule, known as the nominal value rule. It is based on paragraph 10 of Schedule 13 to FA 1996.
1764. *Subsection (3)* sets out the condition that must be satisfied for the rule in this section to apply. It is that the aggregate nominal value of deeply discounted securities issued after an original non-deep discount issue should exceed the aggregate nominal value of all the other securities issued under the prospectus up to that time.
1765. *Subsection (4)* provides the rule, which is that if the condition in subsection (3) is satisfied, all the securities issued under the prospectus will be treated, for the purposes of any later acquisition or disposal, as if they were deeply discounted securities when they were acquired. This applies even if the securities are not deeply discounted securities within the terms of section 430 or are not deeply discounted securities because of the application of the basic rule in section 435.
1766. *Subsections (5) and (6)* provide that a security is not a deeply discounted security for the purpose of applying this rule if it is only a deeply discounted security because it is issued to a person connected with the issuer or acquired by a person who becomes so connected as set out in section 435(2) and the person holding it at the relevant time is not so connected.

Section 437: Transactions which are disposals

1767. This section defines the events giving rise to the income tax charge (or loss relief) relating to deeply discounted securities. It is based on paragraphs 1, 4 and 5 of Schedule 13 to FA 1996.
1768. *Subsection (1)* brings together the occasions in Schedule 13 to FA 1996 which give rise to profits. The subsection includes occasions when someone “transfers” a deeply discounted security or “becomes entitled ... to any amount on its

redemption” (paragraph 1(2) of that Schedule) and a profit is realised. It also includes the conversion of the security into shares or other securities.

1769. The essential point is that the person no longer owns the security and has realised a profit, or sustained a loss, when ownership ceases. The events giving rise to the tax charge are referred to by the section as “disposals” and all the circumstances in which a disposal occurs (apart from under the special rules applying for strips of government securities) are described in this one section.
1770. *Subsection (3)* deals with a deemed transfer of a deeply discounted security to personal representatives immediately before death, in the source legislation found in paragraph 4(2) of Schedule 13 to FA 1996. It crystallises the increase in value at the time of death. “Personal representatives” is defined in section 878(1) of this Act.

Section 438: Timing of transfers and acquisitions

1771. In most cases it is clear when a disposal occurs. But this section provides a timing rule for transfers and acquisitions where that may be less clear; for example, where the holder of a security enters into an agreement to sell the security to someone else at a future date. The section is based on paragraph 4 of Schedule 13 to FA 1996.
1772. The section provides for the security to be treated as transferred (or acquired) when the agreement for the transfer of the security is made, so long as the person receiving it becomes entitled to it at that time. Where an agreement to transfer a security is conditional, the agreement is treated as made when the condition is satisfied.
1773. The words in brackets in paragraph 4(4) of Schedule 13 to FA 1996 (“whether by the exercise of an option or otherwise”) have been omitted as an unnecessary example.

Section 439: Calculating the profit from disposals

1774. This section provides the rules for computing the profit on a disposal. It is based on paragraph 1 of Schedule 13 to FA 1996.
1775. *Subsection (2)* disallows any deduction for incidental costs on acquisition or disposal of a deeply discounted security. But (*subsection (3)*) this is subject to the deductions rule in subsection (4) and the rule on securities held since 26 March 2003 in section 455.
1776. *Subsection (4)* allows a deduction from the profits on disposal for incidental expenses if incurred before 27 March 2003. The term “relevant costs” in Schedule 13 to FA 1996 has been replaced with “incidental expenses”.
1777. *Subsection (5)* deals with the case where a security has been sold and re-acquired, ensuring that it is the later acquisition only that is relevant for ascertaining the profit.

Section 440: Market value disposals

1778. This section deals with the situations in which the amount payable on disposal is determined to be the market value. It is based on paragraphs 4, 6, 8 and 9 of Schedule 13 to FA 1996.
1779. In Schedule 13 to FA 1996 these rules importing market values occur in five separate paragraphs but have now been put into this one section. There are now two rules.
1780. *Subsection (1)* introduces the first rule in which the transfer of a security of a type within *subsection (2)* is treated as disposed of for an amount equal to its market value at the time of the disposal. This is subject to the second rule, in subsection (4).
1781. *Subsection (4)* is the second rule. It is a qualification of the first rule and applies for a particular type of transaction. Where a deeply discounted security is converted into shares or other securities the security is instead treated as disposed of for an amount

equal to the market value of the shares or securities acquired. But this is subject to a special rule for strips which has been signposted at *subsection (5)*.

Section 441: Market value acquisitions

1782. This section deals with all the situations in which the acquisition cost of deeply discounted securities is to be determined at market value. It is based on paragraphs 4, 5, 8 and 9 of Schedule 13 to FA 1996.
1783. *Subsection (2)* provides a list of the disposals giving rise to acquisitions to which the rule in *subsection (1)* applies. The list includes the acquisition of a deeply discounted security as the result of the conversion of a security into shares or other securities – *subsection (2)(b)*. See *Change 86* in Annex 1.
1784. Also included in *subsection (2)(a)* of the list is the acquisition of a security transferred to a legatee by personal representatives. See *Change 86* in Annex 1.

Section 442: Securities issued in accordance with qualifying earn-out right

1785. This section provides rules for ascertaining the acquisition value of a security which forms the whole or part of the consideration on the disposal of a business. It is based on paragraph 3A of Schedule 13 to FA 1996.
1786. This section prevents a profit on deeply discounted securities being charged to capital gains tax as well as to income tax under this Chapter. Where a right to securities to be issued at some future date is part of the consideration for the disposal of a business (an “earn-out right”), a chargeable gain will arise on the difference between the right to receive those securities and their value when issued.
1787. When the securities are eventually disposed of, a deep discount may arise on the difference between the value of the right when granted (as for the chargeable gain described above) and the disposal proceeds. But this may include the increase in value that has already been included in the computation of a chargeable gain. By making the acquisition value for the deep discount legislation the same as the disposal value of the right for capital gains tax purposes, the double counting of that proportion of the discount for income tax purposes is avoided.
1788. The provision is rewritten by providing the valuation rule for securities issued as a “qualifying earn-out right” in *subsection (2)* and then defining a “qualifying earn-out right” in *subsections (3) to (6)*.

Section 443: Application of this Chapter to strips of government securities

1789. This section acts as an introduction to sections providing special rules for computing profits and gains on strips of securities issued by the government of any territory. It is based on paragraph 14 of Schedule 13 to FA 1996.

Section 444: Meaning of “strip” in Chapter 8

1790. This section defines “strip” for the purposes of this Chapter. It is based on section 47 of FA 1942.
1791. FA 2003 widens the definition of “strip” for Schedule 13 to FA 1996 by including securities issued by *any* government. This applies to strips acquired after 26 March 2003. In accordance with our intention of including within Chapter 8 the rules relating to strips acquired before 27 March 2003 the previous, narrower, definition has been retained in *subsection (1)(c)*. Whether the strips fall under *subsection (1)(b)* or *(c)* the conditions set out in *subsections (2) to (5)* must be met.
1792. *Subsections (2) to (5)* rewrite the relevant conditions in section 47 of FA 1942. The definition in Schedule 13 to FA 1996 cross-refers to that section.

Section 445: Strips of government securities: acquisitions and disposals

1793. This section provides the rules necessary for computing profits on the disposal of government securities. It is based on paragraph 14 of Schedule 13 to FA 1996.
1794. *Subsection (1)* is the first rule. It determines, by means of a formula, the acquisition cost where a gilt-edged security which is not a strip (and therefore under section 432(1)(b) not a deeply discounted security) is “stripped”. The acquisition cost of each strip is computed by apportioning the market value of the underlying security between all the strips acquired.
1795. *Subsection (2)*, which contains the second rule, deals with a deemed transaction which counts as a disposal. This is the deemed transfer, followed by immediate reacquisition under *subsection (3)*, of a strip held on 5 April.
1796. Paragraph 14(4) of Schedule 13 to FA 1996 provides for a deemed reacquisition on 6 April for the same value as the disposal on 5 April. This is rewritten as disposal and immediate reacquisition. See *Change 87* in Annex 1.
1797. See paragraph 80 of Schedule 2 to this Act for the application of this rule for 2005-06.
1798. *Subsection (5)* ensures that incidental expenses are not allowed in respect of these deemed transfers even where they were incurred before 27 March 2003.
1799. The rules in subsections (2) to (5) ensure that anyone holding a strip of a government security is taxed year by year on the increase in value of the strip. This is intended to prevent investing in strips, rather than in unstripped government securities (where interest would be taxed year by year), to defer tax liability.
1800. *Subsection (6)*, which contains the final rule, deals with the situation where two or more strips are brought together and turned into a single security. Each strip is disposed of for an amount equal to its market value on consolidation.
1801. *Subsections (7)* and *(8)* ensure that both the first and final rules take precedence over both the rule on timing and transfers in section 438 and the market value rules at sections 440(4) and 441.

Section 446: Strips of government securities: relief for losses

1802. This section allows relief for losses that arise on disposals of strips of government securities. It is based on paragraph 14A of Schedule 13 to FA 1996.
1803. *Subsection (7)* prevents a double claim for loss relief by providing that relief cannot be claimed under this section if section 454 (listed securities held since 26 March 2003: relief for losses) applies.

Section 447: Restriction of profits on strips by reference to original acquisition cost

1804. This section restricts profits to the amount by which disposal proceeds exceed the original acquisition cost. Because there is a 5 April revaluation of strips on a deemed disposal each year the cost taken into account on actual disposal is the last 5 April value. This section ensures that in such cases a profit cannot exceed the difference between the disposal proceeds and the original cost of the security. It prevents taxation of an artificial gain and is the obverse of the loss restriction in section 448. See paragraph 81 of Schedule 2 to this Act where strips are acquired before 15 January 2004. The section is based on paragraph 14D of Schedule 13 to FA 1996.
1805. *Subsection (1)* sets out when the rule in this section applies, namely when a profit would, apart from this section, arise on disposal but the market value of the strip is less than the amount paid by the person to acquire the strip, thus giving rise to a greater profit than would be the case if the market value had not replaced the cost.

1806. *Subsections (2) and (3)* restrict that profit to the excess of the disposal proceeds over the cost of acquisition. If there is no excess because the acquisition cost does not exceed the market value, no profit is made.
1807. *Subsections (4) and (5)* require that the deemed disposal on 5 April (section 445) is to be ignored in considering the original acquisition cost. Paragraph 14D(6)(b) of Schedule 13 to FA 1996, which provides that the original acquisition cost should reflect the open market value rules, is not rewritten. It is considered unnecessary given that the purpose of the open market value rules for acquisition costs applies for the purposes of the whole Chapter (section 441).

Section 448: Restriction of losses on strips by reference to original acquisition cost

1808. This section restricts losses to the amount by which disposal proceeds exceed the original acquisition cost. Because there is a 5 April revaluation of strips on a deemed disposal each year the cost taken into account on actual disposal is the last 5 April value. This section ensures that in such cases a loss cannot exceed the difference between the disposal proceeds and the original cost of the security. The section is based on paragraph 14D of Schedule 13 to FA 1996.
1809. *Subsection (1)* sets out when the rule in this section applies, namely when a loss would, apart from this section, arise on disposal but the market value of the strip is less than the amount paid by the person to acquire the strip, thus giving rise to a greater loss than would be the case if the market value had not replaced the cost.
1810. *Subsections (2), (3) and (4)* restrict that loss to the excess of the disposal proceeds over the cost of acquisition. If there is no excess because the acquisition cost does not exceed the market value, no loss is made.

Section 449: Strips of government securities: manipulation of acquisition, sale or redemption payments

1811. This section applies where there is a scheme or arrangement and the main, or one of the main, benefits that is expected to accrue is the obtaining of a tax advantage. It substitutes market value in any case where the acquisition cost is more than the market value, or the disposal or redemption proceeds are less than market value. The section is based on paragraph 14B of Schedule 13 to FA 1996.

Section 450: Market value of strips etc.

1812. This section provides the rule for ascertaining the market value of a strip or a security exchanged for a strip. It is based on paragraph 14E of Schedule 13 to FA 1996.

Section 451: Market value of strips etc. quoted in foreign stock exchange lists

1813. This section provides the rules for ascertaining the market value of overseas strips or securities quoted on a foreign stock exchange. It is based on paragraph 14E of Schedule 13 to FA 1996.
1814. *Subsections (4) and (5)* make provision for cases where the mechanics of overseas stock exchanges might differ from those in the United Kingdom, in particular where separate buy and sell prices are not given.
1815. *Subsection (6)* acts as a tie-breaker where the strip or security is listed on more than one foreign exchange.

Section 452: Power to modify this Chapter for strips

1816. This section allows the Treasury to make regulations for the treatment of strips as a response to future developments in the strips market. It is based on paragraph 14 of Schedule 13 to FA 1996.

Section 453: Application of sections 454 to 456

1817. This section is the first of four sections providing special rules for securities held since 26 March 2003. FA 2003 introduces several changes to Schedule 13 to FA 1996 which affect securities held after that date. It is based on paragraph 6 of Schedule 39 to FA 2003.
1818. With the one exception for government strips, loss relief is no longer available for disposals on or after 27 March 2003, nor is there a deduction for incidental expenses incurred on or after that date. Where, however, a deeply discounted security held since before that date is disposed of, loss relief is still available if the security is listed on a recognised stock exchange. Although the provisions for these reliefs are repealed by FA 2003 for securities acquired after 26 March 2003 they are rewritten in this Chapter to make it easier for the taxpayer with securities acquired before 27 March 2003 to ascertain the relevant rules. Paragraph 7 of Schedule 13 to FA 1996 which deals with losses on certain exempt income is rewritten in paragraphs 82 and 83 of Schedule 2 to this Act as it is of limited application.

Section 454: Listed securities held since 26th March 2003: relief for losses

1819. This section provides for any loss sustained on the disposal of a listed deeply discounted security to be relieved by set-off and explains when a loss is incurred. It is based on paragraphs 2 and 6 of Schedule 13 to FA 1996.
1820. *Subsection (2)* provides that a loss is incurred where the amount paid on acquisition exceeds the amount paid on disposal disregarding any incidental costs. Incidental costs may increase the loss but not create a loss. See section 455 for how the loss is computed.
1821. *Subsection (3)* signposts section 455(2) to (4) which allow costs in computing the profit where the security has been continuously held since 26 March 2003.
1822. The set-off rules for persons who are not trustees (*subsection (4)*) differ from those for trustees (*subsection (5)*).
1823. See paragraphs 82 and 83 of Schedule 2 to this Act for further provisions on trustees.

Section 455: Listed securities held since 26th March 2003: calculating the profit or loss on disposals

1824. This section gives the rules for computing profits and losses on disposals of securities held continuously since 26 March 2003. Deductions for incidental expenses of acquiring and disposing of deeply discounted securities are only available for listed securities held on 26 March 2003. The section is based on paragraphs 1, 2, 14 and 15 of Schedule 13 to FA 1996.
1825. *Subsections (2)* and *(3)* explain how to compute the loss referred to in section 454(2). The loss sustained is effectively increased by the deduction of the incidental expenses incurred in connection with the acquisition and disposal of the security. This is expressed by allowing the costs, which include both sets of incidental expenses and the cost of acquisition, as a deduction from the disposal proceeds.

Section 456: Securities issued to connected persons etc. at excessive price: subsequent transfers to connected persons

1826. This section prevents a loss arising on the transfer of deeply discounted securities where securities are issued at a value above that at which they are subsequently transferred and the issue and transfer are to connected persons. The section is based on paragraph 9A of Schedule 13 to FA 1996.
1827. The market value rules in sections 440 and 441 do not apply to securities on issue but only to subsequent disposals. The application of those rules therefore produces a

loss where a security has been issued at above the market value to a connected person and is then transferred to another connected person at market value. These transactions thereby benefit from the fact that the market value rules do not apply on issue, and when they might apply, on a transfer, the price is at market value.

1828. *Subsection (1)* provides the general rule that no loss will arise where certain conditions are met. These conditions are set out in subsections (2) to (6).
1829. The conditions in *subsections (2)* and *(3)* must both apply, together with either the condition in *subsection (4)* or those in both *subsections (5)* and *(6)*. These conditions provide that the person disposing of the security was either connected with the issuing company or controlled it and that the security was acquired on issue at above market value.
1830. It is considered unnecessary to rewrite paragraph 9A(2)(b) of Schedule 13 to FA 1996, because if the transferor were connected with the issuer condition C (paragraph 9A(1)(b) of that Schedule) would apply.
1831. *Subsections (5)* and *(7)* ensure that the rule also applies where a deeply discounted security is issued by a close company where the person to whom it is issued, together with others, controls the issuing company, wherever the company is resident.

Section 457: Trustees

1832. This section gives rules for applying this Chapter to trustees. It is based on paragraph 6 of Schedule 13 to FA 1996.
1833. Under section 429 the person liable is the person making the disposal.
1834. *Subsection (2)* ensures that the profits are treated, for the purposes of Chapter 5 of Part 5 of this Act, as income arising under a settlement and therefore potentially chargeable on the settlor.
1835. *Subsection (3)* ensures that the profits are treated as income in applying the rules on the liability of trustees in Chapter 1C of Part 15 of ICTA.
1836. Paragraph 6(1) of Schedule 13 to FA 1996 refers to amounts “treated as income chargeable to tax”. This must simply mean ‘chargeable to tax’ since paragraph 1 of that Schedule makes use of a straightforward charge on the gain rather than a deemed income approach. The “deemed” wording has not been reproduced. But the wording of the charge has been reflected in section 427.
1837. *Subsection (5)* disapplies subsections (2) to (4) in the case of unauthorised unit trusts. Under section 469(2) of ICTA income arising to the trustees of unauthorised unit trusts is regarded as income of the trustees and not as income of the unit holders and such income is chargeable at the basic rate.

Section 458: Non-UK resident trustees

1838. This section provides that non-UK resident trustees are not charged to tax on profits and gains from deeply discounted securities. It is based on paragraph 6 of Schedule 13 to FA 1996.

Section 459: Transfer of assets abroad

1839. Sections 739 and 740 of ICTA provide rules to counter avoidance of income tax by the transfer of assets abroad. They depend on income being payable to a person resident or domiciled outside the United Kingdom which a person domiciled or resident within the United Kingdom has the power to enjoy. This section provides that profits on a disposal of deeply discounted securities by a non-UK resident or non-UK domiciled person are regarded as income paid to that person for the purpose of those rules. The section is based on paragraph 12 of Schedule 13 to FA 1996.

*These notes refer to the Income Tax (Trading and Other Income)
Act 2005 (c.5) which received Royal Assent on 24 March 2005*

Section 460: Minor definitions

1840. This section provides some minor definitions for the provisions in this Chapter. It is based on section 103 of FA 1996 and paragraph 15 of Schedule 13 to FA 1996 and paragraph 14 of Schedule 25 to FA 2002.